



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

NO PROTEST RECEIVED

Release to Manager, EO Determinations

file

DATE: [REDACTED]

SURNAME: [REDACTED]

Date: DEC 15 2000

Contact Person: [REDACTED]

ID Number: [REDACTED]

Telephone Number: [REDACTED]

Employer Identification Number: [REDACTED]

Dear Applicant:

This is in reply to your application for recognition of exemption under section 501(c)(3) of the Internal Revenue Code.

We have considered the information you have submitted and have concluded you do not qualify for recognition of exemption under section 501(c)(3) of the Code because you are not operating exclusively for exempt purposes.

You were established to buy or otherwise acquire so-called "fixer-upper houses", bring them up to the Department of Housing and Urban Development (HUD) standards and offer them for sale to first time, low income buyers at a competitive market price. You have represented that these activities will be carried on through the HUD section 203(k) Rehabilitation Program. Another aspect of your program is to make grants or gifts to assist the purchasers of your properties and perhaps other individuals wishing to purchase properties meet some of the closing costs he or she would have to incur in order to purchase the property in question. You have stated that you will act on behalf of your prospective purchasers and perhaps others to obtain real estate loan packages from various banks and mortgage companies. The fees for such loans will be set by the market forces. You have also indicated that you may be providing counseling to help buyers and guide them through the problems of filing financing applications, executing housing contracts and closing loans. It does not appear that you have entered into any activities yet.

The HUD 203(k) Rehabilitation Program is a housing loan program which provides financing to both purchase and rehabilitate residential properties. Under this program rehabilitation not only includes making a property livable but also can include minor or cosmetic repairs, remodeling, expanding a unit and improving the landscaping of the site. Participation in this program is available to exempt organizations and even to private investors. The financing is provided by local lending institutions which have been approved by HUD and to minimize risk to the mortgage lender HUD insures the loan.

Under this HUD program, private investor home buyers must pay a 15% down payment, but qualified nonprofit organization buyers and individual buyers who will use the home as their principal residence may pay a lower down payment (i.e. may receive a larger mortgage loan for a given property). Under HUD Handbook directive 4155.1 REV-4 I-5, the non-profit must be described in IRC 501(c)(3) and have two-years experience as a provider of housing for low-and-moderate income persons.

Although you have indicated that you will only be assisting low income individuals or families, the guidelines you follow indicate that you will be operating under set maximum income levels which exceed the median income level in [REDACTED] and [REDACTED] the area within which your

operations are based. You will only sell properties to individuals or families who have qualified for Federal Housing Administration (FHA) mortgages.

Your president and CEO is also the president of [REDACTED] ([REDACTED]). One of the other two directors is the office manager of [REDACTED]. You describe this company as being in the business of submitting loan packages to different lending institutions in order to secure loans for clients of real estate agents. You emphasize that [REDACTED] is not a finance company nor a lending institution. Furthermore, you have represented that you will only refer clients in search of down-payment assistance to [REDACTED]. If one of your clients requests that you do so.

You expect to be funded through contributions from the public and from the difference between the purchase price of the homes to be rehabilitated, the cost of rehabilitation and the sales price after you have rehabilitated the property.

Section 501(c)(3) of the Code describes organizations organized and operated exclusively for religious, charitable and educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-(a)(i) of the Income Tax Regulations states that in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more purposes specified in that section. If an organization does not meet either the organizational or the operational test, it is not exempt.

Section 1.501(c)(3)-(c)(i) of the regulations provides that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more of the purposes specified in section 501(c)(3) unless it serves a public rather than a private interest. Thus, to meet these requirements, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) in its generally accepted legal sense. It includes relief of the poor and distressed, the advancement of religion, the advancement of education and lessening the burdens of government.

Section 1.501(c)(3)-(d)(3) of the regulations defines the term "educational" as including the instruction or training of the individual for the purpose of improving or developing his capabilities.

Section 1.501(c)(3)-1(e)(1) of the regulations provides that an organization may meet the requirements of section 501(c)(3) of the Code although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purposes of carrying on an unrelated trade or business as defined in section 513. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes. An organization which is organized and operated for the primary purpose of

carrying on an unrelated trade or business is not exempt under section 501(c)(3) even though it has certain religious purposes, its property is held in common and its profits do not inure to the benefit of individual members of the organization.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945), Ct.D. 1650, C.B. 1945, 375, the Supreme Court of the United States held that the presence of a nonexempt purpose, if more than insubstantial, would destroy tax exempt status as a charitable organization.

In United States v. Wells Fargo Bank, 485 U.S. 351, 108 S. Ct. 1179, 99 L.Ed. 2d 368 (1988), the Supreme Court held that an organization must prove unambiguously that it qualifies for a tax exemption.

Harding Hospital, Inc. v. United States, 505 F.2d 1068 (1974), holds that an organization seeking a ruling as to recognition of its tax exempt status has the burden of proving that it satisfies the requirements of the particular exemption statute. Whether an organization has satisfied the operational test is a question of fact.

In Old Dominion Box Co. v. United States, 477 F.2d 344 (4th Cir. 1973) cert. Denied 413 U.S. 910 (1973), the court held that operating for the benefit of private parties constitutes a substantial non-exempt purpose.

In B.S.W. Group, Incorporated v. Commissioner, 70 T.C. 352 (1980), the Tax Court held that an organization which operated at a profit whose only role is that of a conduit linking individual researchers with interested client organizations, both exempt and nonexempt, did not qualify for exemption under section 501(c)(3) of the Code. It was conducting a consulting business of the sort which is ordinarily carried on by commercial ventures organized for profit.

Rev. Rul. 70-585, 1970-2 C.B. 115, provides that nonprofit housing organizations created to aid low and moderate income families by lessening neighborhood tensions, eliminating prejudice and discrimination, and combating community deterioration may qualify for exemption under section 501(c)(3) of the Code.

The Revenue Ruling provides several illustrations of organizations which might qualify for exemption under section 501(c)(3). In situation #1 an organization providing homes for low income families who otherwise could not afford them was considered to be relieving the poor and distressed and qualify for exemption under section 501(c)(3). In situation #2 an organization formed to ameliorate the housing needs of minority groups by building housing units for sale to persons of low and moderate income on an open occupancy basis was determined to qualify for exemption under section 501(c)(3). In situation #3 an organization formed to formulate plans for the renewal and rehabilitation of a particular area in a city as a residential community was held to qualify for exemption under section 501(c)(3). The organization's purposes and activities combat community deterioration by assisting in the rehabilitation of an old and run-down residential area, they are charitable within the meaning of section 501(c)(3) of the Code. On the other hand situation #4 held that an organization formed to build new housing facilities for the purpose of helping families to secure decent, safe, and sanitary housing at prices they can afford did not qualify for exemption under section 501(c)(3). The organization planned to erect housing that it to be rented at cost to moderate income families. Because the organization's program did not provide relief to the poor or to carry out any other charitable purpose within the meaning of the regulations applicable to section 501(c)(3) of the Code, it was not entitled to exemption from Federal income tax under section 501(c)(3) of the Code.

Rev. Proc. 96-32, 1996-1 C.B. 717, provides guidance on the qualification under section 501(c)(3) for organizations engaged in low income housing. The Rev. Proc. provides that an organization will be

considered to relieve the poor and distressed if it establishes that 75 percent of the units are occupied by residents that qualify as low-income and that either (a) 20 percent of the units are occupied by very low-income residents or (b) 40 percent of the units are occupied by residents that do not exceed 120 percent of the area's very low-income limit. In addition, the units must be affordable to these residents. This will ordinarily be satisfied by adopting a government-imposed rent restriction. This revenue procedure also describes a facts and circumstances test that will apply to determine whether organizations that fall outside the safe harbor relieve the poor and distressed such that they will be considered charitable organizations described in section 501(c)(3).

Examples 3 and 6 of section 5 of Rev. Proc. 96-32 illustrate the application of the safe harbor and facts and circumstances test alternative set forth in Rev. Proc. 96-32.

Example 3 describes an organization which provides affordable homeownership opportunities to purchasers determined to be low-income under a federal housing program. The homes are scattered throughout a section of the organization's community. Beneficiaries under the program cannot afford to purchase housing without assistance. The organization's program makes the initial and continuing costs of mortgages affordable to the home buyers by providing assistance with down payments and closing costs. Homeowners assisted by this organization will have the following composition: 40 percent will not exceed 140 percent of the very low-income limit for the area, 25 percent will not exceed the low-income limit, and 35 percent will exceed the low-income limit but will not exceed 115 percent of the area's median income. The organization does not satisfy the safe harbor. However, the facts and circumstances demonstrate that the organization relieves the poor and distressed.

Example 6 describes an organization which provides homeownership opportunities to purchasers with incomes up to 115 percent of the area's median income. The organization does not meet the income levels required under the safe harbor. The organization's board of directors is representative of community interest, and it provides classes and counseling services for its residents. The facts and circumstances do not demonstrate that the organization relieves the poor and distressed.

Whether an organization has satisfied the operational test is a question of fact. See Harding Hospital, Inc. v. United States, *supra*. In addition, the existence of more than an substantial nonexempt purpose will preclude exemption. See Better Business Bureau of Washington, D.C., Inc. v. United States, *supra*. As emphasized by the Supreme Court in United States v. Wells Fargo Bank, *supra*, qualification must be proven unambiguously.

The information you have submitted indicates that your primary activity is to carry on a program under which you will purchase homes through the HUD 203(k) program, rehabilitate them, and sell them to qualifying private individuals at market value. You will assist the individuals and families in purchasing the house by providing some of the funds they will need for the down payment. It also appears that you will assist these individuals and perhaps others seeking to purchase these homes in obtaining FHA loans. The individuals and families who can participate in your program includes individuals or families whose income levels exceed the median income levels of the area as determined by HUD guidelines.

An organization established to provide or assist in providing housing can qualify for exemption under section 501(c)(3) of the Code. However, as stressed in Rev. Rul. 70-585, *supra*, a charitable program is generally only found where the individuals receiving the assistance comprise a charitable class or the housing itself accomplishes a recognized charitable purpose. Here you have set your guidelines to assist individuals and families who qualify for FHA mortgages and have income at levels which exceed the median income level of the area within which you are operating. This does not establish a charitable class. In addition, not all housing within the greater [redacted] area or within [redacted], is located in an economically distressed or deteriorated area. We also note that rehabilitation

[REDACTED]

within the meaning of the section 203(k) program has a different meaning than rehabilitation for the purposes of section 501(c)(3) of the tax Code. Under the HUD program rehabilitation can include minor or cosmetic repairs, remodeling, expanding a unit and improving the landscaping of the site. Rehabilitation for the purposes of section 501(c)(3) has a much more restrictive meaning. Furthermore, providing down payment assistance or helping individuals or families which can qualify for FHA approved loans is not necessarily a charitable endeavor. As above the individuals and families who can use your program do not constitute a charitable class and participating in the HUD rehabilitation program is not a charitable endeavor. Your activities in the housing market are indistinguishable from those of any investor or for-profit business which can qualify under the 203(k) program or any facilitator or agent working with the lending industry. Accordingly, we have concluded that you are not benefiting a charitable class and are merely operating a trade or business. Therefore, you do not qualify for exemption under section 501(c)(3) of the Code.

Similarly, the facts and circumstances tests of Rev. Proc. 96-32, supra, do not provide grounds for exemption.

Although an organization can meet the requirements of section 501(c)(3) of the Code even though it operates a trade or business as a substantial part of its activities, qualification for exemption is only present if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purposes of carrying on an unrelated trade or business as defined in section 513. Inasmuch as you have been unable to establish that your business activities further an exempt purposes, we are unable to conclude that you qualify for exemption under section 501(c)(3) of the Code.

In addition, we note that your president and CEO is also the president of CCMC. In addition, one of the other two directors is the office manager of CCMC. You describe CCMC as being in the business of submitting loan packages to different lending institutions in order to secure loans for clients of real estate agents. You emphasize that CCMC is not a finance company nor a lending institution. Furthermore, you have represented that you will only refer clients in search of down-payment assistance to CCMC if one of your clients requests that you do so.

However, it is clear from the above information that CCMC is in a situation where it can potentially benefit substantially through the normal operation of your program. Where the principals of an organization are in a position to benefit from the operations of an exempt organization exemption may be precluded. See Old Dominion Box Co. v. United States, supra. Without additional safeguards in place which would preclude private benefit from taking place, it appears that under the circumstances you have described the potential for private benefit is too great. Therefore, we are unable to conclude that you will qualify for recognition of exemption under section 501(c)(3).

Accordingly, we have concluded that you have not established that you qualify for recognition of exemption under section 501(c)(3) of the Code. Contributions to you are not deductible under section 170 and you are required to file Federal income tax returns.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your principal officers, must be submitted within 30 days from the date of this letter. You also have the right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your principal officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practice Procedures.

[REDACTED]

If you do not protest this proposed ruling in a timely manner, it will be considered by the Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the United States Tax Court, the U.S. Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

Sincerely yours,

Joseph Chasin

Joseph Chasin
Acting Manager,
Exempt Organizations
Technical Group 2

cc: [REDACTED]

cc: [REDACTED]

[REDACTED]

[REDACTED]